



Financial Planning for Early Retirement

If you happen to be one of those physicians who has planned on retiring early, say at age 50 to 60, it is always a good time to check the state of your financial affairs and consider possible changes to your early retirement strategy. Several planning opportunities -- some old, some new -- exist to aid in your quest, so be prepared to:

- take a comprehensive approach;
- think "outside of the box;" and
- be flexible.

THE KEY QUESTION

How much do I need to retire early? Simply put, the answer depends on how much you spend and for how long you will be spending it. Accountants and financial planners like to cite the 70% rule of thumb, which suggests that you will be able to retire comfortably on a wealth base that can generate 70% of your pre-retirement earnings for your life expectancy. However, the 70% rule assumes that your living expenses will decrease by 30%, and that's just not likely to happen if your idea is to use early retirement to increase your enjoyment of life and enrich your existence (i.e., typically voluntary early retirement means more recreation, more entertainment, more traveling, etc.). The better approach is to assume that your desired lifestyle will cost the same, if not more, than what you spend while working.

Another rule of thumb developed through life expectancy, inflation and market return studies suggests that you need about \$200,000 to \$250,000 in capital for every \$10,000 in annual pre-tax income required. The research in this area suggests that a safe withdrawal rate of one's capital is about 4% annually. For example, using a 4% withdrawal rate, a thirty-year life expectancy and annual income needs of \$150,000, you should have \$3,750,000 in capital accumulated prior to commencing early retirement.

RECOUPING AND REORGANIZING

A key step toward maintaining an early retirement track is to look for ways to recoup investment losses suffered during the market declines. If the past is any indicator, remember that it's certainly reasonable to assume that the market will cycle back to achieve at least partial recovery in value. A common market cycle will take anywhere from one to three years to complete, which means that if you have targeted early retirement to commence more than 5 years from now, you will likely regain some of the lost value.

But market cycles will account for only some recoupment. Fortunately, the tax laws encourage the timing is good for prospective early retirees to take greater control of their wealth planning.

Face it. If a volatile market environment is too much to wait out, get serious about increasing your ongoing annual retirement plan contributions. If you are not maximizing your funding, now is the time to take advantage of recent developments as well as new laws aimed directly at enhancing retirement opportunities.

Basic "defined contribution" pension or profit sharing plans now allow the employer to contribute 25% of your earnings up to \$44,000 into your plan account annually. The \$44,000 figure is up \$2,000 from last year. Thus, an ophthalmologist earning at least \$176,000 can receive the maximum dollar contribution.

401(k) plans now have increased limits on employee voluntary amounts (\$15,000 annually). Note, that the voluntary amounts count against the \$44,000 per person limit.

When you hit age 50, you can also increase your voluntary 401(k) contribution with a "catch-up" amount (\$5,000 annually). More importantly, catch-up contributions are *not* counted against the annual \$44,000 maximum.

Although somewhat more complicated than defined contribution plans, individuals who are age 45 and older should examine the possibility of either starting or switching to a "defined benefit" pension plan. This type of plan allows substantially higher annual contribution amounts than the \$40,000 limit set on defined contribution and 401(k) plans. Defined benefit plans are very suitable to individuals at or near retirement age because contributions are keyed (in part) to how long a person has before scheduled retirement. The shorter the time to scheduled retirement, the greater the amount that can be contributed.

There may be some resistance to increasing funding in your practice's pension or profit sharing or 401(k) plans because of the added costs associated with funding the non-physician employees. Almost without exception, however, the retirement and tax benefits gained on the physician side of the equation out weigh the dollar cost of additional contributions for your staff.

TAKE A HARD LOOK AT EXPENSES, AND THEN LOOK AGAIN

Serious potential early retirees (those who have done more than just dream about it) know that there may be choices to make from time to time to keep the plan on track. They know there are two sides to the plan: income *and* expenses.

Understand that the idea of "living below your means" is a common element in many early retirement plans. That theme is increasingly relevant, even to the well-paid ophthalmologist, if you have definitive ideas about exiting early from the working world. Settling for less than what you can afford now, while you are a full capacity income earner, obviously increases your odds at recouping lost wealth at a faster pace. Early retirement planning is, in effect, a personal cost/benefit analysis of what you're spending now and how those expenditures fit with the values you place on your early retirement lifestyle.

Obviously, you need to have a personal or family budget and you need stick to it as closely as possible. As you look down the road, recognize that some expenses will be eliminated or reduced once you retire (e.g., work-related costs, home improvements and furnishings), and some expenses will increase (e.g., leisure and travel, the cost of care for an elderly parent). In a proactive sense, however there are key expense areas--housing and personal insurance for example-- that warrant review by any potential retiree. On the housing side, decide if your current home is essential for your retirement years. You may conclude that you'd be quite comfortable in a smaller place and/or in a less expensive region. If you're too "connected" to your present area, consider a less expensive community in the same region. As to personal insurance, your life and disability policy premiums may be depleting your wealth significantly without purpose. If you have saved enough for the education of your children and if you have paid off your mortgage (or close to it), indeed these policies may be absolutely unnecessary.

Early retirement planning is an evolving process. Keep your eye on the prize and be prepared to make necessary adjustments on both sides of the ledger.

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